

School for Traders & Investors

Sixty-Third Lesson

Distribution, or Letting the Public Get Off—Which?

Showing Why Patience and Knowledge of Fundamentals Is Essential

THE accompanying chart of the important price movements of International Harvester, from the period of accumulation at the beginning of the present bull market up to the present time, serves to illustrate another condition whereunder the chart reader may deceive himself unless he is acquainted with the fundamental qualities of his stock.

Seasoned issues having investment quality are usually accumulated at the beginning of a bull market. Investors and long-pull speculators plan to hold such a stock until it has discounted all the favorable possibilities of the company's business cycle. Those traders who depend too much on nearby technical indications of charts and tape are likely to fall into the error of losing their advantageous long position during the first period of hesitation in the advance. This period of hesitation is caused by selling on the part of short-swing traders who desire to take profits. The market must absorb this profit-taking before the stock can make its next substantial advance.

A Deceptive Period

The stock will sometimes move up and down within a narrow trading zone for a period of a month or more, until it is sufficiently absorbed to proceed with the next step of its steady upward trend. During this period, in addition to the selling on the part of the short-swing trader who desires to take profits so that he may switch into some other issue that he believes will return quicker profits, there is usually considerable selling by inexperienced speculators who buy on bulges and are scared out of their position because the stock appears to be turning heavy.

Such selling would not take place to the same extent if the holders were fully acquainted with the merits of their stock. Knowledge of the financial posi-

tion of the company, and its earning ability, would often show that a much higher price should be anticipated. However, the wise investor and trader, knowing that each substantial advance will encourage a certain amount of profit-taking, will not continue to absorb his favorite issue following a sharp advance, but he will wait patiently for the almost inevitable reactions that take place while the stock is "consolidating its new position."

Getting Into Strong Hands

While the stock is thus indulging in a series of small reactions and rallies before proceeding on its way, all of the weak holders who desire to do so are given an opportunity to dispose of their stock, which passes into the accounts of better informed investors and

traders who are patiently waiting to absorb it at the most advantageous price. In other words, the big fellows are letting the public get off, and it is not unusual under such circumstances for the professional traders to bring about apparent weakness over a brief period by sudden selling, or lowering of their buying orders, so as to encourage the little fellow to mistake absorption for distribution, and thus let go of his stock at a price favorable to the buyer.

Referring to the chart, it will be observed that following the accumulation around the 75 level, the stock entered trading zones around the 85, 95, 105 and 115 levels. To the inexperienced chart reader, these zones carry the suggestion of inability to advance, and probability of a setback. To the sophisticated trader, who knows the statistical position of the stock, these levels are simply opportunities to let the little fellows get off.

From the appearance of the chart at the 105 level, it is probable that a good many got off thereabouts, and that some premature short selling may have been indulged in, to say nothing of a little panicky feeling on the part of numerous amateurs who may have bought on bulges, on a thin margin, and who evidently did not have the courage of their conviction.

The Lesson

The point we wish to make to the student is: Don't mistake a temporary trading zone for distribution, but investigate your stock and determine whether there is any common sense reason why the stock should be liquidated at the level in question. If its asset value and earning ability justify much higher prices, why relinquish your advantage to someone else? Certainly not much could be gained from such an action.

